

# **AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA LEGISLATURE AND THE COUNCIL ON THE NKOMAZI LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Nkomazi Local Municipality, which comprise statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, as set out on pages [xx] to [xx].

### **Accounting officer's responsibility for the annual financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **Auditor-General's responsibility**

1. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) (Constitution), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
2. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
3. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Basis for qualified opinion**

### **Property, plant and equipment**

5. Sufficient appropriate audit evidence could not be obtained as to the existence, rights, completeness and valuation of infrastructure assets, as disclosed in note 4 to the financial statements to the carrying value of R538 399 545 (2009: R518 785 934), due to the incomplete classification and identification of the assets in the fixed asset register. I was unable to perform suitable alternative procedures, due to the poor quality of the fixed asset register, including a lack of descriptions, locations, asset numbers and bar codes.
6. Sufficient appropriate audit evidence could not be obtained as to the existence, rights, completeness and valuation of the game included in heritage assets, as disclosed in note 4 to the financial statements to the carrying value of R12 105 777 for the current and previous financial years. Furthermore, the game counted at year-end was valued at R6 054 673, resulting in an unreconcilable difference of R6 051 104. I was unable to perform suitable alternative procedures due to the type of asset, i.e. game, concerned.
7. The additions to property, plant and equipment of R88 921 769 as disclosed in note 4 to the financial statements, does not agree to the additions balance of R92 670 023 per the fixed assets register. The entity did not reconcile or provide any supporting documentation for the difference of R3 748 254 between the fixed assets register and the financial statements. Consequently, the additions to property, plant and equipment is misstated by R3 748 254.

### **Investment property**

8. Sufficient appropriate audit evidence could not be obtained as to the existence, rights, completeness and valuation of investment property, as disclosed in note 3 to the financial statements to the value of R8 167 900 as at 30 June 2010, due to the incomplete classification and identification of the assets in the investment property register. I was unable to perform suitable alternative procedures, due to poor quality of the investment property register, including a lack of plot numbers and locations.

### **Provision for leave pay**

9. There was no system of control over the leave taken and entitlement to employees on which I could rely for the purpose of my audit. There were no suitable alternative audit procedures that I could perform to obtain reasonable assurance that all leave days had been properly recorded in the leave register. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of the leave pay provision of R9 316 761 as disclosed in note 17 to the financial statements.

### **Valued-added tax**

10. Sufficient appropriate audit evidence could not be obtained as to the rights, completeness and valuation of the value-added tax (VAT) receivable amount of R17 587 805 as disclosed in notes 12 and 49 to the financial statements, since the municipality incorrectly used the invoice basis to calculate this balance. This was not in line with their current registration with the South African Revenue Service (SARS) and has led to the municipality not receiving refunds until a VAT investigation is concluded by SARS. I could not determine the effect on the other account balances or classes of transactions presented in the financial statements.

## **Revenue**

11. Distribution losses of electricity for the 2009 financial year were not determined.
12. Distribution losses of electricity for the current financial year amounting to R1 465 037 as disclosed in note 21 to the financial statements were incorrectly calculated, as material omissions were identified from the calculations performed. As a result, I could not obtain sufficient appropriate audit evidence as to the completeness and accuracy of the accounting records beyond the actual receipts recorded, and therefore revenue from the sale of electricity to the amount of R30 284 312 (2009: R25 729 467).
13. Distribution losses of water for the current and previous financial years were not determined. As a result, I could not obtain sufficient appropriate audit evidence as to the completeness and accuracy of the accounting records beyond the actual receipts recorded, and therefore revenue from the sale of water to the amount of R9 118 520 (2009: R7 692 954) as disclosed in note 22 to the financial statements. I was unable to perform suitable alternative procedures, as the municipality's financial system did not provide detailed descriptions and information for these transactions.
14. Details of the updated property valuation roll were not disclosed in the financial statements, as disclosed in note 20 to the financial statements.

## **Commitments**

15. Commitments to the value of R20 186 063 were not disclosed in note 39 to the financial statements. Furthermore, there was no contract management system for the identification and recognition of contracts and therefore there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments had been properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of commitments of R78 758 335 as disclosed in note 39 to the financial statements.

## **Qualified Opinion**

16. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Nkomazi Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with SA Standards of GRAP and in the manner required by the MFMA.

## **Emphasis of matters**

I draw attention to the matters below. My opinion is not modified in respect of these matters:

## **Restatement of corresponding figures**

17. As disclosed in notes 42 and 43 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of a reclassification and an error discovered during the current financial year in the financial statements of the municipality at, and for the year ended, 30 June 2009.

### **Unauthorised, fruitless and wasteful as well as irregular expenditure**

18. As disclosed in note 47 to the financial statements, unauthorised expenditure of R27 153 299 was incurred and condoned, while R101 311 364 was incurred but not condoned.
19. As disclosed in note 48 to the financial statements, fruitless and wasteful expenditure of R88 745 was incurred during the period under review.
20. As disclosed in note 49 to the financial statements, irregular expenditure of R18 425 884 was incurred during the period under review.

### **Additional matter**

I draw attention to the matter below. My opinion is not modified in respect of this matter:

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

21. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA and the Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), and financial management (internal control).

### **Predetermined objectives**

22. Material findings on the report on predetermined objectives, as set out on pages [XX] to [XX], are reported below:

### **Non-compliance with regulatory and reporting requirements**

23. Section 53(1)(c) of the MFMA states that the mayor of a municipality must take all reasonable steps to ensure that the municipality's service delivery and budget implementation plan (SDBIP) is approved by the mayor within 28 days after the approval of the budget. However, the municipality's SDBIP was not approved in the specified timeline.

### **Reliability of reported performance information**

The following criteria were used to assess the reliability of the planned and reported performance:

- Validity: Has the actual reported performance occurred and does it pertain to the entity, i.e. can the reported performance information be traced back to the source data or documentation?
- Accuracy: Have amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?
- Completeness: Have all actual results and events that should have been recorded been included in the reported performance information?

The following audit finding relates to the above criteria:

### **No supporting source documents**

24. Sufficient appropriate audit evidence could not be obtained in relation to any of the selected objectives. There were also no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information.

### **Compliance with laws and regulations**

#### **Municipal Finance Management Act**

##### **The accounting officer did not adhere to his/her responsibilities**

25. Contrary to section 1 of the MFMA, expenditure was not incurred in accordance with the requirements of the supply chain management policy of the municipality or the requirements of the municipality's by-laws giving effect to such policy.
26. Contrary to section 64(2)(a) of the MFMA, the municipality did not have an effective revenue collection system.

##### **Transfer and disposal of assets were not made in accordance with the applicable legislation**

27. Contrary to section sec 14 (2)(a)(b) of the MFMA, the municipality disposed of assets without evidence that that the fair market value of the disposed assets were considered and that the economic and community value to be received in exchange for the disposed assets were performed.

##### **Expenditure was incurred otherwise than in accordance with sections 15 and 11(3) of the MFMA resulting in unauthorised expenditure**

28. The accounting officer did not ensure that expenditure was incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality.

##### **Expenditure was incurred in vain or could have been avoided resulting in fruitless and wasteful expenditure**

29. Expenditure incurred was made in vain, and could have been avoided had reasonable care been exercised.

##### **Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure**

30. Expenditure was not incurred in accordance with the requirements of the supply chain management policy of the municipality or municipal entity or the requirements of the municipality's by-laws giving effect to such policy as set out in [section1 the definition of "irregular expenditure" paragraph (d) of the MFMA].

**Supply Chain Management legislative requirements were not implemented or not adhered to**

31. Contrary to section 116 the accounting officer did not take all reasonable steps to ensure that a contract or agreement procured through the supply chain management policy of the municipality or municipal entity is properly enforced.

**The financial statements were not prepared in accordance with applicable legislation**

32. Although the municipality does have a fixed asset register, this register has not been maintained properly as required by section 63(2)(c) of the MFMA.
33. Contrary to section 62(1) of the MFMA, the accounting officer of the municipality is responsible for managing the financial administration of the municipality and must for this purpose take all reasonable steps to ensure that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards which was not performed during the period under review.
34. Contrary to section 65(2)(c) of the MFMA, the municipality did not maintain a system of internal control in respect of creditors and payments.
35. Contrary to section 125(2)(d) of the MFMA, the municipality did not disclose all particulars of any material losses recovered or written off.
36. Contrary to section 125(2)(e) of the MFMA, the municipality did not disclose all areas of non-compliance with the MFMA in the notes to the financial statements.

**INTERNAL CONTROL**

37. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, MSA, Municipal Regulations and DoRA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
38. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

**• Leadership**

Oversight responsibility over the preparation of financial statements, report on predetermined objectives, compliance with laws and regulations and internal control was not exercised by the accounting officer. The leadership did not ensure that there was a process in place to ensure that reviews took place before submission. This was also evidenced by the numerous instances of non-compliance with laws and regulations, previous year audit findings not addressed, internal control deficiencies and material misstatements in the financial statements noted throughout the audit process.

**• Financial and performance management**

The financial statements were not reviewed prior to submission for auditing and were subject to material amendments resulting from the audit. Procedures pertaining to the valuation and classification of property, plant and equipment were not performed, while supply chain management was not fully effective.

Requested information was not available and supplied without any significant delays.

- **Governance**

Risk identification and management processes were not designed to identify changes in processes or risks and verify that the design of underlying controls remained effective. The municipality had not selected and developed internal controls to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

There was no evidence that management had taken action during the period being reviewed to address fraud risk due to the absence of a fraud prevention strategy.

Ongoing monitoring and supervision were not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting.

## **OTHER REPORTS**

### **Investigations**

39. An investigation was concluded regarding the suspended municipal manager and as a result the municipal manager was relieved of his duties during the period under review.

Mbombela

30 November 2010



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